

IN THE UNITED STATES DISTRICT COURT  
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

In the matter of	:	CIVIL ACTION
	:	NO. 99-4094
U.S. PHYSICIANS	:	
	:	BKY. NO. 98-34011

MEMORANDUM ORDER

This is an appeal from a final order of the United States Bankruptcy Court. Appellants are the Trustee for entities affiliated with debtor U.S. Physicians and HCFP Funding Inc. They contend that the Bankruptcy Court erred in finding that appellees did not violate the automatic stay provision, in not awarding punitive damages for a willful violation of that provision and in awarding \$60,000 rather than \$167,602.50 in compensatory damages for conversion.<sup>1</sup>

The court has appellate jurisdiction over final orders of the Bankruptcy Court pursuant to 28 U.S.C. S 158(a)(1) and reviews de novo the Bankruptcy Court's conclusions of law. In re Ben Franklin Hotel Associates, 186 F.3d 301, 304 (3d Cir. 1999); In re Eagle Enterprises, Inc., 265 B.R. 671, 674 (E.D. Pa. 2001); In re Equipment Leassors of Pennsylvania, 235 B.R. 361, 363 (E.D. Pa. 1999). The Bankruptcy Court's findings of fact are reviewed for clear error. Fed. R. Bankr. P. 8013; In re Ben Franklin Hotel Associates, 186 F.3d at 304.

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<sup>1</sup> Daniel M. Grauman, Esq., trustee for U.S. Physicians has joined in the brief filed by the appellants.

Bone and Joint Specialists of Western Pennsylvania ("B & J") was a professional corporation comprised of Doctors Smith and Fritz ("the Doctors") who practiced in Franklin, Pennsylvania. In January 1997, Drs. Smith and Fritz entered into an asset purchase agreement with U.S. Physicians, Inc. ("USP") by which they sold to USP all of the assets of B & J, including the B & J trade name, telephone numbers and outstanding accounts receivable.

The Doctors simultaneously entered into five-year employment agreements with U.S. Medical Services of Pennsylvania, P.C. ("PA PC") by which they were no longer responsible for expenses associated with the B & J practice and all B & J employees, including the Doctors, became PA PC employees. The employment agreement specified that the Doctors must turn over all fees paid or assigned to them for professional services performed during the term of the agreements.

The agreement provided that USP would "arrange" for billing and collecting receivables generated by the Doctors. The parties agreed, however, that the Doctors would continue to perform the billing and collection functions at their offices as they had greater success with collections. The office thus continued to send out invoices to third-party payors like Medicare and Blue Shield as B & J, and continued to use the B & J provider number. B & J continued to be named on accounts with

utilities and suppliers, although USP was obligated under the purchase agreement to pay B & J expenses. Several accounts remained in the name of Dr. Fritz or Dr. Smith from the period before the two merged their practices.

PA PC established a bank account over which the Doctors had no signatory authority but into which they would regularly deposit collected receivables. On two or three occasions they withheld collected receivables in an effort to prompt PA PC to pay outstanding bills. The Doctors otherwise promptly deposited all receivables into the PA PC account.

USP's concept faltered when it was unable to undertake an IPO. On October 28, 1998, USP, PA PC and other affiliated entities filed Chapter 11 bankruptcy petitions. These were converted to Chapter 7 cases on November 9, 1998.

After October 22, 1998, the Doctors began to deposit B & J receivables into an old B & J account which then contained a few hundred dollars. They used the funds to pay employee salaries, past due utility bills and supplier invoices, and to provide start-up capital for each of their new separate practices. They no longer operated as B & J after October 30, 1998.

On November 13, 1998, both doctors received a letter from cross-appellant Christine Schubert, trustee for PA PC and affiliated entities ("the Trustee"), explaining the effect of the

automatic stay and instructing them immediately to turn over all estate property including collected prepetition receivables.

On January 15, 1999, the Bankruptcy Court entered an Order authorizing the Trustee to use a portion of HCFP's collateral to administer the USP estate. It required the Doctors' practices affiliated with USP to turn over all prepetition accounts receivable collected and to provide an accounting of the same to the Trustee. The Doctors nevertheless continued to write checks from the B & J account containing the receivables.

By January 28, 1999, the Doctors had remitted \$219,127.29 of receivables to PA PC's estate which was less than the total amount collected. The Doctors made further payments of \$96,220.72 in late March 1999 and of \$48,490.26 on May 13, 1999. The Doctors finally remitted \$41,416.46 on June 1, 1999 for a total of \$555,254.73.

The Doctors contend that the receivables were not property of the bankruptcy estate because the initial employment contract was modified by performance, that PA PC waived its ownership interest in the receivables by relying on the Doctors' billing and collection efforts, and that some portion of the

funds representing overpayments are not part of the bankruptcy estate and should be held in constructive trust.<sup>2</sup>

A unambiguous contract is interpreted according to its terms. See In re Penn Central Transportation, Co., 831 F.2d 1221, 1225-28 (3d Cir. 1987). The Doctors do not contend that the contract is ambiguous. Rather, they contend that the practice of allowing them to collect receivables in the B & J name effected a modification of the contract. This practice, however, was not inconsistent with the contract terms. By consistently depositing the receivables in the PA PC account, the Doctors performed according to the terms of the contract.

Property of the debtor becomes property of the estate to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold. See 11 U.S.C. § 541(d); Mid-Atlantic Supply, Inc. of Virginia v. Three Rivers Aluminum Co., 790 F.2d 1121, 1124 (4th Cir. 1986). A court may impose a constructive trust where one holds property subject to an equitable duty to convey it to another and the holder would be unjustly enriched if he were to retain the property. See Pierro v. Pierro, 264 A.2d

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<sup>2</sup> In contending that the contract was modified, appellants rely on PA PC's consent to their billing and collection efforts, the fact that they held themselves out to suppliers, patients and medical insurers as B & J and the fact that they used the B & J employer identification number for reimbursement by third-party payors.

692, 696 (Pa. 1970). An equitable duty arises only from fraud, duress, undue influence, mistake or abuse of a confidential relationship. In re Sacred Heart Hosp. of Norristown, 175 B.R. 543, 555 (Bankr. E.D. Pa. 1994); Yohe v. Yohe, 353 A.2d 417, 420 (Pa. 1976). To maintain standing, a litigant must show that an order will diminish his property, increase his burdens or impair his rights. See General Motors Acceptance Corp. v. Dykes, 10 F.3d 184, 187 (3d Cir. 1993)

The Bankruptcy Court documented many checks written to patients that were identified as overpayment refunds which the Doctors contend are not property of the estate. The Court declined to impose a constructive trust over those funds given the total absence of any evidence of fraud, duress, undue influence, mistake or abuse of a confidential relationship and the fact that the Doctors had no interest in the funds, and thus lacked standing to seek a constructive trust. The Doctors concede that they have no interest in the overpayments. Although the debtor has a duty to reconvey the property to the rightful owner, the Doctors have no standing to secure a constructive trust and no right to the funds in question.

The filing of a bankruptcy petition operates as a stay applicable to all entities of "any act to obtain possession or property of the estate or of property from the estate or to exercise control over property of the estate." 11 U.S.C.

§ 362(a)(3). An individual injured by a willful violation of the stay "shall recover actual damages, including costs and attorney's fees, and, in appropriate circumstances, may recover punitive damages." 11 U.S.C. § 362(h).

In determining whether the Doctors exercised control over estate property, the Bankruptcy Court concluded that the prohibition does not reach the passive act of possessing the property and that the Doctors thus did not violate the automatic stay.<sup>3</sup> The Bankruptcy Court found that the Doctors converted the funds and awarded the costs incurred in collecting those funds as compensatory damages, but concluded that the Doctors' conduct was not so egregious as to justify the imposition of punitive damages. The Doctors' control over the receivables was not

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<sup>3</sup> Many courts have held that some affirmative act is required before Section 362(h) liability may attach. See Barringer v. Eab Leasing (In re Barringer), 244 B.R. 402 (Bankr. E.D. Mich. 1999); Brown v. Joe Addison, Inc., (In re Brown), 210 B.R. 878 (Bankr. S.D. Ga. 1997); Spears v. Ford Motor Credit Co. (In re Spears), 223 B.R. 159 (Bankr. N.D. Ill. 1998); Massey v. Chrysler Financial Corp., In re Massey, 210 B.R. 693, 696 (D. Md. 1997); Kolberg v. Agricredit Acceptance Corporation (In re Kolberg), 199 B.R. 929 (W.D. Mich. 1996). In re Young, 193 B.R. 620, 624-25 (Bankr. D.D.C. 1996); In re Najafi, 154 B.R. 185, 194-95 (Bankr. E.D. Pa. 1993); In re Richardson, 135 B.R. 256, 259 (E.D. Tex. 1992). The court recognized that other courts had reached a different conclusion. See In re Del Mission Ltd., 98 F.3d 1147, 1151 (9th Cir. 1996); In re Sharon, 234 B.R. 676, 682 (BAP 6th Cir. 1993); In re Sharon, 234 B.R. 676 (6th Cir. BAP 1999); In re Bunton, 246 B.R. 851 (Bankr. N.D. Ohio 2000); Nissan Motor Acceptance Corporation v. Baker, 239 B.R. 484 (N.D. Tex. 1999); In re Zaber, 223 B.R. 102 (Bankr. N.D. Tex. 1998); In re Coats, 168 B.R. 159 (Bankr. S.D. Tex. 1993); Isom v. Yoon (In re Isom), 1998 WL 173204 (Bankr. D. Minn. 1998).

passive. Under any standard, they violated the automatic stay by expending funds properly belonging to the bankruptcy estate.

Conversion is the deprivation of another's right in, or use or possession of, property, without the owner's consent and without lawful justification. See Stevenson v. Economy Bank of Ambridge, 197 A.2d 721, 726 (Pa. 1964); Shonberger v. Oswell, 530 A.2d 112, 114 (Pa. Super. 1987). Conversion occurs when property is delivered to another voluntarily for a specific purpose but is then used for an unauthorized purpose and not returned. See Royal Ins. Co. (UK) Ltd. v. Ideal Mut. Ins. Co., 649 F. Supp. 130, 137 (E.D. Pa.) (collecting cases), aff'd, 806 F.2d 254 (3d Cir. 1986). Money can be the subject of conversion. See Francis J. Bernhardt III, P.C. v. Needleman, 705 A.2d 875, 878 (Pa. Super. 1997); Pearl Assurance Co. v. National Insurance Agency, 30 A.2d 333, 337 (Pa. Super. 1943).

The Doctors contend that the Court should not have imposed liability in a matter involving a dispute as to ownership of property and in any event attorneys' fees are unavailable in a conversion action.<sup>4</sup>

The general rule is that a court may not grant counsel fees to a successful litigant in the absence of statutory or

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<sup>4</sup> The Bankruptcy court found that the Doctors retained property properly belonging to the bankruptcy estate in the belief that their position was justified. This does not absolve them of liability for conversion. See Plack v. Baumer, 121 F.2d 676, 678-79 (3d Cir. 1941).



contractual authorization. See Drummond v. Drummond, 200 A.2d 887, 889 (Pa. 1964). Also, counsel fees cannot be construed as an element of consequential damages when the plaintiff was compelled to institute legal proceedings to recover for the wrongful conduct. See Shanks v. Alderson, 582 A.2d 883, 885 (Pa. Super. 1990). Although there is no statute providing for recovery of counsel fees to the successful litigant in an action for conversion, such fees are recoverable against a party who violates the automatic stay. See 11 U.S.C. § 362(h). The Bankruptcy Court erred in awarding counsel fees as damages on a conversion theory, but the error is harmless as the Doctors violated the automatic stay.

Punitive damages are awarded in cases of egregious conduct. See In re Klein, 226 B.R. 542, 545 (Bankr. D.N.J. 1998); In re Wagner, 74 B.R. 989 (Bankr. E.D. Pa. 1987). To recover punitive damages, a plaintiff must show that a defendant acted knowingly or recklessly to violate a federally protected right. See In re Klein, 226 B.R. at 545. In making this determination, courts look to the nature of the defendant's conduct, the defendant's ability to pay, the defendant's motives and any provocation by the debtor. See In re Cohen & Sons Caterers, Inc., 108 B.R. 482, 487 (E.D. Pa. 1989), aff'd, 944 F.2d 896 (3d Cir. 1991). A decision to award punitive damages and the scope of any such damages are within the discretion of

the finder of fact. See Donaldson v. Bernstein, 104 F.3d 547, 556-57 (3d Cir. 1997).

The Bankruptcy Court found that while the Doctors violated the terms of their employment contracts by failing to remit all fees generated to PA PC, their actions were not egregious. Given USP's inability to pay any staff salaries or expenses, the Doctors reasonably believed that their actions were necessary to ensure the continued viability of their practice. The Court's finding that the Doctors' conduct was not egregious is not clearly erroneous.

While the fact-finder may not award damages on the basis of speculation, he may make a reasonable estimate based on relevant data and may act on probable and inferential as well as direct and positive proof. See Delahanty, 464 A.2d at 1257. See E.C. Ernst, Inc. v. Koopers Co., Inc., 626 F.2d 324, 327 (3d Cir. 1980); Delahanty v. First Pennsylvania Bank, N.A., 464 A.2d 1243, 1257 (Pa. Super. 1983). Appellants requested \$167,602.50 for all fees incurred by HCFP, the Trustee and the Trustee's accountant as a result of all litigation generated by the Doctors' and B & J's filings. After reviewing the corresponding time sheets, the Bankruptcy Court concluded that approximately \$65,000 in fees were reasonably attributable to services performed in connection with recovering the property wrongfully converted by the Doctors and the balance was attributable to other actions including the Trustee's opposition to the Doctors'

claim to some of the proceeds. The Bankruptcy Court's calculation and segregation of fees attributable to recovery of the converted funds from those expended to challenge the Doctors' claim of right was reasonable and proper.

**ACCORDINGLY**, this                    day of December, 2002, upon consideration of the Appeal in the above civil action from the Order entered on June 30, 1999 by the Hon. David A. Scholl, **IT IS HEREBY ORDERED** that said order of the Bankruptcy Court is **AFFIRMED** and this action is closed.

**BY THE COURT:**

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**JAY C. WALDMAN, J.**